

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-135958-07

Date:

January 08, 2008

Legend:

X =

A =

B =

LLC1 =

LLC2 =

LLC3 =

Year 1 =

State =

Date 1 =

Business =

Property 1 =

Property 2 =

Property 2 =

\$M =

\$N =

Year 2 =

Dear :

This letter is in response to your letter, on behalf of X, dated August 6, 2007, seeking a ruling regarding passive investment income under § 1362(d)(3) and § 1375 of the Internal Revenue Code.

Facts

Based on the materials submitted and representations within, we understand the relevant facts to be as follows. X was incorporated in Year 1 in accordance with the laws of State. X made an election to be treated as an S corporation effective Date 1. X has accumulated earnings and profits (AE&P) from prior years. X owns A and B, which X has elected to treat as Qualified Subchapter S Subsidiaries (QSubs), also effective Date 2. X is engaged in the active trade of Business. X also owns LLC1, LLC2 and LLC3, which are treated as disregarded entities for federal tax purposes.

X, through its disregarded entities, LLC1, LLC2 and LLC3, owns Property 1, Property 2 and Property 3 ("the Properties"), commercial real estate properties that are leased to tenants. X, through its employees or various independent contractors, provides certain services with respect to the leasing of the Properties. These services include maintaining and repairing common areas, including sewage, electrical and water supplies; maintenance and repair of parking lots, roofs, gutters, downspouts, signage, landscaping; snow and ice removal; pest control; maintenance and repair of structural elements and foundation.

In Year 2, X collected approximately \$M in gross rents and incurred approximately \$N in relevant operating expenses.

Law and Analysis

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(3)(A) provides that a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items of the S corporation.

Section 1361(b)(3)(B) provides that a qualified subchapter S subsidiary means any domestic corporation which is not an ineligible corporation if 100 percent of the stock of such corporation is held by the S corporation, and the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 1362(d)(3)(A)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earning and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. The termination is effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i). Section 1362(d)(3)(A)(ii).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(1) defines "rent" as amounts received for the use of, or right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that the term "rents" does not include rents derived in the active trade or business of renting property. Rents are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and types and amounts of costs and expenses incurred (other than depreciation).

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income.

Conclusion

Based solely on the facts as presented in the ruling request, and viewed in light of the applicable law and regulations, we conclude that the income that X derives from the rental activities of the Properties is income from the active trade or business of renting property and is not passive investment income as described in 1362(d)(3)(C)(i) because X provides significant services and incurs substantial costs in its rental business.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X satisfies the S corporation eligibility requirements of § 1361. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter will be sent to the taxpayer's representative.

Sincerely,

/s/

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes

cc: